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# Corporate distributions -- Liquidating and dividend

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# Corporate Distributions–Liquidating and Dividend

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One of the definitions of pitfall is "a danger, difficulty, or error into which one may fall unsuspectingly." There is a connotation here of blamelessness or innocence. This is the meaning intended when the word is used with reference to the shareholders.

A pitfall has also been defined as "a snare for the unwary," and unwary as being "careless, heedless, or not vigilant." It is in this context that the term will undoubtedly be applied if it is used with reference to trouble spots that should have been avoided by us in our role of professional advisors.

The decision rendered by the Western District Court of Louisiana in *Bancroft* v. *Indemnity Insurance Company of North America* is particularly in point.

T. P. Bancroft was the owner of controlling stock in two corporations. On two separate occasions he sold stock of one company to the other. Before the sales he had been assured in writing by his certified public accountants that the transactions would not result in any income tax liability. Although this was not reported as a tax case, it is apparent that one corporation was used to redeem the stock of a related corporation. Under such circumstances, sections 304 and 302 may be applicable, and the corporate distribution can be considered equivalent to a dividend. Such treatment was evidently appropriate with respect to the proceeds of the Bancroft sales because subsequently, as a result of the transactions, he was required to pay income tax deficiencies exceeding $35,000.

Mr. Bancroft brought action to recover the additional assessment from the accountants' professional liability insurer and won his case. The presiding judge discounted the contention that accountants were not qualified to answer questions of tax law and stated that the court was protecting innocent clients against a CPA's professional negligence.

## BASIC PROBLEMS

The basic problems in this area of corporate distributions can be stated in terms of both cause and effect. As to cause, we are concerned with—

1) a failure to recognize a corporate distribution as such, or
2) an incorrect presumption that a corporate distribution would qualify as a payment either in redemption of stock or in partial or complete liquidation of the company.

The effect of the first problem could be the attribution of dividend income where none was expected; and of the second, the imposition of dividend or ordinary income treatment where capital gain was presumed.

The problems might be reduced still further to two basic questions.

1) Is there a distribution?
2) If so, how should it be taxed?

The questions serve only to put the problems into focus, since the answers must be tailored to fit each situation as it arises.

**Approach to Problems**

Probably the most important prerequisite toward developing the proper answers is a familiarity with the statutory provisions. It is essential that the distribution problems be identified with applicable code sections. However, it must be recognized, at the same time, that the language of the Internal Revenue Code is frequently so broad as to be of little help in many instances.

As a matter of fact, the shortage of specific guidelines is the very core of this discussion.

We know that, in order for a distribution to be taxed as a dividend, the corporation must have earnings and profits.

We know from the Regulations that a bargain purchase can create a dividend problem and that, likewise, the cancellation of stockholder debt can result in dividend treatment.

The rules of certain specific redemption and liquidation situations are sufficiently well set forth in the law so that planned results are possible.

A substantial volume of court decisions has established that, with respect to the taxability of dividends, they need not be pro rata, a formal declaration is not essential, and the payments do not have to take the commonly recognized form of a dividend.

All of these are positive assertions. They are illustrative of what can be relied upon when analyzing distribution problems.

### "Essentially Equivalent to a Dividend"

The best example of nebulousness, on the other hand, is in the Code's frequent use of the words "essentially equivalent to a dividend." This phrase, or some variation of it, has been part of tax law for more than forty years. In 1920, the Supreme Court, in the Macomber case, held that the then existing law taxing stock dividends was unconstitutional. This opened the door to tax avoidance through bailouts; consequently, Congress, in its Revenue Act of 1921, provided that if, after distributing a stock dividend, a corporation reacquired its stock "at such time and in such manner as to make the distribution and cancellation or redemption essentially equivalent to the distribution of a taxable dividend. . ." the amount received would be so taxed.

Although since then it has also been used countless times in the language of court decisions, the phrase often produces more questions than answers. It defies specific application. It is representative of the undefined area in which are concealed many pitfalls.

Since vulnerability in this area cannot be precisely measured, we must draw on case histories and published rulings for appropriate guidelines. Problem transactions are too numerous to permit a comprehensive coverage, but a review in retrospect does provide a selection of pertinent cases in the following areas:

1) constructive dividends
2) redemptions
3) partial liquidations

## CONSTRUCTIVE DIVIDENDS

The term is used with reference to situations resulting in a dividend tax, where the recipient was unaware that such treatment was imminent or even possible. The taxpayer could be vulnerable as a result of conditions that have existed for many years.

### Related Businesses Conducted Together

The direct impact of the imputed dividend is often borne by the corporation rather than by the stockholders, by virtue of the fact that the income had been reported by the shareholders, but as something other than a dividend. Good examples of this may be found in the cases of banks and related insurance agencies. In a typical situation, the insurance purchased by bank customers is written through an agency operated by bank officers or employees. The two businesses are normally conducted under the same roof and more often than not the agency has never been charged for its use of the facility.

Such was the case with the Bank of Kimball.[1] Before 1951 it had operated an insurance agency in Kimball, South Dakota. In January of that year, the directors resolved that all commissions on insurance, auction sales, and rents should be removed from the bank's earnings for the coming year. Effective with 1951, and with no further formality through 1956, the agency profits were distributed directly to seven stockholders and directors, each of whom reported his share for income tax purposes. In December of 1956, a formal partnership agreement was executed and, beginning with 1957, partnership returns were filed annually.

The court sustained a determination of the Revenue Service that the bank should be taxed on agency profits for the years 1954, 1955, and 1956. Returns for the preceding three years were protected by the statute of limitations.

This problem is not restricted to bankers. Moke Epstein, Inc.,[2] operated an automobile dealership, and its president, Morris Epstein, as an individual, sold automobile insurance. The Internal Revenue Service attempted unsuccessfully to tax the commissions to the corporation, maintaining that the income to Mr. Epstein represented dividends.

Some of the factors to be considered in a case of this type were well set forth in *First Security Bank* v. *U. S.*,[3] which was also decided for the taxpayer. Items in support of the bank's contention that the insurance agency was a separate entity were enumerated as follows:

1) the existence of a partnership,
2) the regular filing of a partnership tax return,
3) a bona-fide business purpose for operating the agency as a separate entity and lack of evidence of tax avoidance,
4) the maintenance of a separate bank account and separate set of books,
5) the carrying on of correspondence and other communications in the name of the partnership on stationery and forms bearing the agency name, and

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1 *Bank of Kimball,* 9 AFTR 2d 573 (DC SD 1962)
2 *Moke Epstein, Inc.,* 29 TC 1005 (1958)
3 *First Security Bank* v. *U. S.,* 11 AFTR 2d 856 (DC Mont. 1963)

6) the lack of control by the bank through any action of its board of directors.

Factors listed as supporting the government's position were:

1) common personnel,
2) common premises,
3) payment by the bank of the entire salaries of all bank officers and employees who devoted part of their time to the insurance business, and payment of all other expenses of the agency as well,
4) the failure to pay any consideration for the transfer of the assets,
5) the participation by the agency in excess loans without the payment of interest by the bank, and
6) the distribution of profits in the same proportion as stock ownership.

Although a preponderance of plus factors in the First Security Bank case resulted in a victory, the fact that the trial was made necessary by the existence of the negative items should not be overlooked. This is always true, of course, when issues are not clear-cut and there are opposing points of view.

The Revenue Service has become increasingly active in this area, possibly motivated by the realization that even where the activities cannot be combined, some allocation of expenses may be appropriate.

Where related but separate businesses are conducted under the same roof, the importance of well-defined entities and an arm's-length philosophy of operation should be emphasized.

**Significance of Separate Corporate Entity**

Many shareholders fail to appreciate the significance of the separate corporate entity. The writer was personally acquainted with an old gentleman who, many years ago, transferred investment stocks to a newly created holding company. Our Firm was engaged by him to help contest a very substantial deficiency attributable, in part, to his withdrawal of some of these same shares. Almost to the day he died, he insisted that since he had put the stocks into his company, he should be able to take them out without incurring a tax liability.

Many bargain purchases reflect a lack of understanding of the degree of separateness of the corporate structure. The shareholders recognize that a withdrawal of property without consideration may be labeled a dividend, so they circumvent this by purchasing the property—but at an amount less than fair value. One current controversy, which may get to court, concerns the purchase of all of the stock of a subsidiary by the stockholders of the parent. The initial investment was $25,000 and this was the price paid by the stockholders about eight months later. The shareholders, in turn, subsequently sold the stock to unrelated parties for $200,000. As a consequence, the Treasury Department has proposed deficiencies based on an alleged $175,000 bargain. The principal argument for the shareholders under the specific circumstances, relates to the valuation at the time of their purchase.

The inability or refusal to recognize the separate pocketbook of a corporation is responsible for many compensation cases. For example, the C. J. Duffey Paper Co.[4] paid $1,800 annually as compensation and directors fees to the sister of the president of the company, despite the fact that she had rendered little or no services and attended no directors meetings during the years in question. At least, this is what the court determined in the absence of any convincing evidence to the contrary.

The taxpayers had claimed that the sister, who lived in an adjoining state, had served as a contact to help expedite orders from suppliers in that area. If this were so, the company should have required the sister to submit written contact reports, expense statements, and other correspondence. Since she did not, the salary payments were disallowed as deductions and taxed as dividends to Mr. Duffey and his wife. It is not inconceivable that, had the annual compensation to Mr. Duffey's sister been greater than $6,000, the subject of gift taxes might have been added to the issues.

In *Schner-Block Co., Inc.,*[5] the directors of the company, Charles Schner, Jr., his wife and his mother, orally agreed to pay the widowed mother a pension of $200 a month for life. The company had no pension or death benefit plan, and had never made similar payments to any other employee's widow. The mother had never worked for the company. The action was never reflected in the minute books. The payments were not contractual. Because of this complete lack of documentation, the taxpayer was not able to present a convincing argument.

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[4] *Duffey* v. *Lehert,* LL AFTR 2d 1317 (DC Minn. 1963)
[5] *Schner-Block Co., Inc.,* TC Memo. 1963-166

**Stockholder Loans**

One gets the impression from reviewing some cases that taxpayers have taken a so-called calculated risk without realizing the extent of the risk. In many instances, when a stockholder borrows money from his wholly owned corporation, he must be aware that a simple withdrawal would be taxable to him; otherwise, no reason exists for the debt classification. Since the necessity for the indebtedness has obviously been recognized, it is difficult to understand why so many stockholder-owners fail to perfect the debt.

This is not to imply, however, that establishing a valid debt, by itself, will solve the problem.

Mr. and Mrs. E. W. Chism[6] withdrew from their corporation (in addition to salaries) about $48,000 over a five-year period. Although the withdrawals were recorded as "E. W. Chism—Notes Receivable," no notes were executed nor any other written instructions given. The accounts were unsecured, bore no interest, and were not repaid. The Commissioner determined that the withdrawals constituted a distribution of informal dividends and was sustained both by the Tax Court and by the Ninth Circuit. It was interesting to note that, before the Tax Court's decision but subsequent to Mr. Chism's death in late 1956, someone apparently recognized the necessity for establishing the existence of the debt and the matter was brought before the Nevada Probate Court, which ruled that the withdrawals gave rise to an enforceable claim by the corporation against the estate. This decision was introduced as support to the taxpayers' contentions. The Circuit Court acknowledged the effectiveness of the Probate Court's holding, but added, "But it is not the existence of a legal obligation to repay that is controlling. It is petitioners' intent to honor, and the intent of their collective alter ego, the corporation, to enforce that obligation which determines the nature of the withdrawals."

The Tax Court's memorandum decision earlier this year in *Fender Sales, Inc.*[7] stated similarly, "The fact that the corporation reflected the withdrawals in the form of a receivable is not a controlling factor and particularly so when the withdrawer is in control of the corporation. This same reasoning applies to the execution of a promissory note, since the executing and collection of the $40,000

[6] *Estate of E. W. Chism,* 12 AFTR 2d 5300 (CA-9 1963)
[7] *Fender Sales, Inc.,* TC Memo. 1963-119

note were, for all practical purposes, under the control of Fender."

On the basis of a great many court decisions on this issue, it would appear that a stockholder could safely borrow from his controlled corporation—even at something less than complete arm's length. For instance, the corporation might grant the loan at a time when a commercial lender would be reluctant to do so; or the loan may be on an unsecured basis whereas a bank would insist on collateral, but the debt must be an honest one. In many cases other than those cited, considerable weight has been given to the form of the transaction. A promissory note with stated maturity and bearing interest at commercial rates is bound to be more favorably regarded. When a stockholder loan is looked at retrospectively, however, there is no substitute for a showing of repayment.

In a given situation, a successful contention on the loan issue may be analogous to winning a skirmish, but the battle might still be lost. The making of loans to shareholders could, of itself, precipitate a proposed deficiency based on section 531, and in any event would be considered adversely in a determination of whether or not earnings had been accumulated unwarrantedly.

**Rent**

It would appear that the directors of Fairmount Park Raceway, Inc.,[8] were tempting fate when they agreed to pay 100 per cent of profits as rent for race track facilities to a partnership comprised of the corporation's shareholders or their relatives. The Revenue Service, relying on an expert's comprehensive study of track rentals, was sustained in its determination that excess rents amounting in the aggregate to almost $1 million should be taxed to the individuals as dividends.

**Advertising**

W. D. Gale, Inc., an electrical contractor, deducted as advertising expense the cost of maintaining and operating racing boats. The deduction was denied and the disallowed amounts were taxed to the company's president, Joseph A. Schoenith,[9] as a constructive dividend.

**Summary**

These cases are illustrative of the broad area encompassed by the term dividend. The use of corporate funds for personal benefit is

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[8] *Fairmount Park Raceway, Inc.,* TC Memo. 1962-14
[9] *Joseph A. Schoenith,* 9 AFTR 2d 344 (CA-6 1961)

too easily rationalized by controlling shareholders. Many of these situations need the detached look that a certified public accountant can give. It is up to us to recognize and to point out the problems and to suggest appropriate solutions. This is good tax practice.

**REDEMPTIONS**

The frequency of adverse court decisions relating to redemptions is puzzling. Possibly the payment of tax on capital gains is naïvely accepted as an insurance of immunity against additional taxation; or, the fact of having surrendered stock shares in return for the distribution has effectively rationalized the taxpayer's position. Whatever the reasons may be, it is apparent that too many shareholders resort to redemptions as convenient solutions to the problem of siphoning profits from a corporation. Often, when subsequent examination has led to proposed dividend treatment, taxpayer rebuttals have been weak.

In *Henry and Bessie Silver,*[10] the court considered the following criteria in arriving at its decision in favor of the Commissioner.

1) Did the corporation adopt any plan or policy of contraction of its business activities?
2) Did the corporation follow an orderly procedure looking towards its ultimate dissolution or its ultimate contracted operation?
3) Did the initiative for the corporate distribution come from the corporation, based on usual considerations, or did it come from the stockholders for their own purposes?
4) Is the proportionate ownership of stock by the stockholders changed?
5) What were the amounts, the frequency, and the significance of dividends paid in the past?
6) Does the capitalization, at the time of the purchase of the stock, represent capital paid in or earnings from the business?
7) Was there a sufficient accumulation of earned surplus to cover the distribution, or was it partly from capital?
8) Was there maintenance of an approximately similar amount of capital liability, or did that figure decrease to a degree somewhat comparable to the purported distribution of capital?

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[10] *Henry Silver,* 11 AFTR 2d 871 (DC Mont. 1963)

9) Was there good faith or bad in the action of the Board of Directors in making the distribution?

10) What was the net effect of the action taken?

In the opinion of the court, the last-mentioned item was the most important.

The answers to virtually all of these questions were prejudicial to the taxpayers, and they lost their case. The decision was rendered under the 1939 Code, but the underlying philosophy has been carried forward into present law.

The decision in *Eva D. Bradbury*[11] by the Court of Appeals for the First Circuit reflects the provisions of the 1954 Code.

A business purpose was introduced by the taxpayers as support to the contention that a distribution in redemption of stock by a family-owned corporation was not essentially equivalent to a dividend, pursuant to section 302(b)(1). The Court was advised that the redemption was made to extinguish a liability of Mrs. Bradbury to the corporation, at the suggestion of the company's banker, from whom a loan had been requested.

On the basis of all of the facts submitted, and noting that Mrs. Bradbury's constructive ownership of stock had decreased only from 91 per cent to 90 per cent, the Court rejected this argument and sustained the dividend treatment of the distribution amounting to approximately $22,500.

**CPA Can Be Unwitting Accomplice**

Early last summer a client and the writer had lunch together for the purpose of discussing in general the subject of redemptions. The requirements of the substantially disproportionate test and the consequences of complete redemption were outlined, and some of the business purposes that had been accepted by the courts as prevailing over a presumption of dividend equivalence were noted. The writer recalls mentioning that several cases had been won by taxpayers who had redeemed stock to provide shares for resale to key employees.

The luncheon guest was the vice-president of a closely held prosperous manufacturing concern. The directors had resisted the payment of dividends although the surplus accumulation was substantial.

A few weeks later, the writer was advised that the corporation was about to redeem 150 shares of the president's stock for $45,000,

[11] *Eva D. Bradbury*, 9 AFTR 2d 398 (CA-1 1962)

representing its approximate book value. The alleged purpose of the redemption was to provide shares for sale to department heads. Two of them had already committed themselves to the purchase of ten shares apiece.

It was apparent that after the redemption the president and his immediate family would still own more than 75 per cent of the outstanding stock, that stock would not be offered to other employees, and that the twenty-share commitment was about all the two department heads would be able to purchase in the foreseeable future. All in all, this was a poor transaction. The president was about to withdraw profits under the guise of a redemption, which he expected to justify with a business purpose the writer had provided—the result of an informal discussion. CPAs should be careful of the role of accomplice they may play in these schemes.

**Ten-Year Agreement**

A redemption of all shares owned by a stockholder shall be indemnified against dividend treatment (resulting from attributed ownership), provided the selling shareholder retains no interest in the corporation other than that of creditor, does not acquire any interest except by inheritance within ten years, and files an agreement to notify the secretary if any such interest is acquired within the ten-year period. The regulations require that the agreement be attached to a timely filed return for the year of redemption.

There is some disagreement about the proper consequence of a delinquent filing of this statement. The Tenth Circuit has indicated in *Van Keppel*[12] that a delinquent submission preceding a deficiency assessment and not rejected by the Director was timely. On the other hand, the Third Circuit has held in the *Estate of Blanche E. Archbold*[13] that a filing three years after the redemption was sufficient cause for negation of the waiver of the constructive ownership rules, and, as a result, dividend treatment was imposed.

**Shoestring Purchases**

In an appropriate circumstance, a redemption may be used effectively as part of a stock-purchase transaction. When a stock acquisition is contemplated, but the purchaser cannot meet the asking price, corporate funds might be used to redeem the shares that the

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[12] *G. W. Van Keppel,* 63-2 UCTC 9683 (CA-10)
[13] *Estate of Blanche E. Archbold,* 11 AFTR 2d 422 (CA-3 1963)

new stockholder was unable to buy. This is an example of a shoestring purchase.

Precautions should be taken with respect to both the purchaser and the seller.

The purchaser should buy all of the stock covered in his commitment. The corporation should not be permitted to assume any part of his obligation, in spite of the fact that Rev. Rul. 59-286, in one situation, has permitted such an assumption. After reviewing an extremely complicated statement of facts, the Eighth Circuit determined in *Edgar S. Idol*[14] that the purchaser's personal obligation to the seller was paid by the corporation; as a result, the Circuit Court sustained a determination of the Tax Court that constructive dividends had been received.

From the seller's standpoint, the sale should precede the redemption. This timing could be important. If the redemption were the first transaction to be completed, the selling shareholder might not be able to show that his surrender of shares was substantially disproportionate or he might conceivably be trapped by the attribution rules of section 318.

Although the redemption was not prompted by shoestring purchase considerations, an example of the operation of section 318 is found in *Thomas G. Lewis*[15] in which the Tax Court stated, "Had this case arisen under the predecessor provisions of the 1939 Code, it might have been possible to find that the redemption was not essentially equivalent to the distribution of a taxable dividend, . . . ."

**Redemption to Pay Death Taxes**

Section 303 relates to the redemption of stock to pay death taxes. The provision has application after the death of a shareholder where the value of stock in the corporation owned by the decedent is more than 35 per cent of his gross estate or more than 50 per cent of his taxable estate. Stock in two corporations can be used, if the gross estate includes more than 75 per cent in value of the outstanding stock of the two companies.

The percentage requirements represent potential hazards to a contemplated redemption, inasmuch as the effectiveness of this device is made dependent on accurate and reliable valuations, not only of the stock of the redeeming corporation but of all of the other assets in the estate. For this reason, it would be desirable, whenever possible,

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[14] *Edgar S. Idol,* 12 AFTR 2d 5118 (CA-8 1963)
[15] *Thomas G. Lewis,* 35 TC 71 (1960)

to delay any redemption under this section until after the estate tax audit has been completed. The applicable time limit for completing the transaction is ninety days after the statute has run on the estate or, if the Tax Court has been petitioned to determine an estate tax deficiency, sixty days after its decision becomes final.

The immunization from dividend treatment is limited in amount to the aggregate of death taxes and duties plus funeral and administrative expenses, but the proceeds of the redemption do not have to be used for those purposes.

In any contemplated section 303 redemption, consideration might be given to the distribution by the corporation of appreciated property (except LIFO inventory, instalment obligations, etc.), in which case the benefits might be compounded.

The scarcity of court decisions on the section 303 redemptions may be a reflection of a general reluctance to gamble on the valuation questions; on the other hand, since this is one of the few distribution situations for which specific guidelines have been provided, it may be that, despite a frequent use of these provisions, disputes have not arisen.

**Redemption Through Use of Related Corporations**

"Section 304 was enacted in the 1954 Code to close loopholes in the tax laws deriving from transactions involving brother-sister corporations." This is borrowed from the language of the court's opinion in *U. S.* v. *Collins*.[16]

R. Perry Collins and his wife, Marjorie, owned all of the stock in Permar Corporation. They also owned 70 per cent of the stock of R. P. Collins & Company, Inc., the remaining 30 per cent being owned directly by or in trust for their daughters. In September 1954, the R. P. Collins & Company, Inc. (which had an earned surplus at the time of approximately $523,000) purchased for $15,000 all of the stock of Permar Corporation.

This represents a classic section 304 application. A retrospective look to determine the net effect of this transaction would lead to the conclusion that the taxpayers had siphoned $15,000 in profits from their corporation without really giving up anything in return. Oddly enough, the Massachusetts District Court did not take this position. It held for the taxpayers on the basis of the following logic:

a) The R. P. Collins & Company, Inc.'s surplus was not diminished as a result of the purchase;

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[16] *U. S.* v. *Collins,* 9 AFTR 2d 1119 (CA-1 1962)

b) the corporation received stock worth the $15,000 paid for it;

c) the individual shareholders received the $15,000, but parted with property of equal value.

An acceptance of this theory would make sections 302 and 304 inapplicable whenever stockholders sold to a related corporation at a fair price. Under such circumstances, section 304 could not justify its own existence.

The First Circuit, reversing the lower court's decision, referred to *Radnitz* v. *U. S.*,[17] wherein it was stated, "After the dust has settled, one finds the plaintiffs and their fellow stockholders as firmly ensconced in their tri-corporate position as was true prior to the stock transaction, with admittedly no true diminution of interest or control despite their transfers of stock."

**Accumulation Penalty**

Any contemplation of a redemption transaction should include some consideration of the vulnerability of the corporation to the penalty tax on unreasonable accumulation. If the decision in *Pelton Steel Casting Co.*[18] were considered to be the dominant authority, the very act of redemption would expose a corporation to the tax under section 531.

However, the more recent conclusions drawn by the court in *Mountain State Steel Foundries, Inc.*[19] are much more compatible. The opinion in this case flatly stated that the fact of redemption, of itself, furnished no basis for imposition of the section 102 (now section 531) tax. It is worth noting, nevertheless, that the same court declared, "We need not say that under no circumstances may a stock purchase be relevant to a question arising under Section 102 of the 1939 Code. When it is done out of cash accumulations which reasonably may be thought excessive, such a purchase, along with other factors, may be considered appropriately in arriving at ultimate findings."

Redemptions do focus attentions on accumulated earnings, and if an accumulation problem exists, this fact must be given weight among the items considered in arriving at a decision.

**PARTIAL LIQUIDATIONS**

Section 346 assures capital gain treatment for redemptions received in connection with certain defined corporate contractions. If

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[17] *Radnitz* v. *U. S.*, 7 AFTR 2d 423 (DC N.Y. 1960)
[18] *Pelton Steel Casting Co.*, 1 AFTR 2d 542 (CA-7 1958)
[19] *Mountain State Steel Foundries, Inc.*, 6 AFTR 2d 5910 (CA-4 1960)

a given transaction appears to fall within the provisions of section 302 also, section 346 will prevail. This can be very helpful, because then we need not be concerned with disproportionate redemptions or attribution or even section 306 dispositions. We must, of course, conform to the provisions of section 346, but if the circumstances fit, compliance is made easy.

If the contemplated transaction does not, in all respects, meet the specifications for automatic capital gains treatment, the business contraction must be sufficiently prominent in the plan to protect the distribution from attack as being essentially equivalent to a dividend. This may not be so easy. In *Estate of Chandler,*[20] the corporate operator of a general department store reduced its operation from five departments to one; its floor space from more than 8,000 square feet to 1,800; its employees from an average of fifteen to five; yet the court held that a redemption of 50 per cent of the corporation's stock was a dividend to the shareholders.

**Rulings**

By their very nature, distribution problems often involve substantial amounts of money. They merit very careful considerations on our part. One way to ensure acceptance is to obtain a ruling from the Internal Revenue Service. The filing of such a request may delay the transaction, but if circumstances permit, the assurance is well worth waiting for.

## CONCLUSION

Only a few of the pitfalls existing within the broad area of corporate distributions have been touched on in this discussion. The Code sections mentioned are replete with other problems. There are many potential pitfalls in other distribution problems outside the scope of this paper, such as those related to spin-offs and other divisive reorganizations, transactions including boot, section 306 and section 341. Our area of responsibility is very great.

[20] *Estate of Chandler,* 48 AFTR 842 (CA-6 1955)